United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

76-7156

United States Court of Appeals

FOR THE SECOND CIRCUIT

MILDRED GALFAND, on behalf of herself and on behalf of AMERICAN INVESTORS FUND, INC.,

Plaintiff and Cross-Appellant,

B 8/5

—against—

CHESTNUTT CORPORATION,

Defendant-Appellant,

—and—

AMERICAN INVESTORS FUND, INC.,

Nominal Defendant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR DEFENDANT-APPELLANT

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Plaintiff and cross-appellant ignores, rather than seeks to justify, the explicit legal error below, namely Judge Brieant's conjectural and subjective standard of "materiality":

> ". . . in the sense that a reasonable investor might consider (it) important . . ." (citations omitted, A-55, column 1).

The identical standard held erroneous by the Supreme Court with its *own* emphasis was:

> "'all facts which a reasonable shareholder *might* consider important.' 512 F. 2d at 330 (emphasis

added)" *T.S.C. Industries, Inc.* v. *Northway,* —— U.S. ——, 44 L.W. 4852, 4854, decided June 14, 1976.

Thus, any possibility that this Circuit might be entice . to a subjective standard of conjecture, away from "... taking a properly realistic view, there is a substantial likelihood ..." (*General Time Corp.* v. *Talley Industries, Inc.,* 403 F. 2d 159, 162 (1968)) and away from the " 'might' formulation is 'too suggestive of mere possibility, however unlikely' " is precluded by the Supreme Court's quotations from both *General Time* and *Gerstle* v. *Gamble-Skogmo, Inc.,* 478 F. 2d 1281, 1301-1302.

Accordingly, the judgment below cannot stand.

The Proper Legal Standard Requires Dismissal as a Matter of Law

Stockholder action was prospective. The same prospective action was taken in three successive years. The action taken brought the contract into conformity with state regulation.

Judge Broderick in Philadelphia, in denying an injunction, quoted four full paragraphs of the proxy statement, including the caption "Approval of the Terms of New Advisory Agreement" (Ex. 2) at A-24. The trial judge quoted only the single first paragraph. The final sentence of the second paragraph of that portion of the proxy statement quoted by Judge Broderick reads:

> "However, no assurance can be given that the annual expense ratio will in fact be at a level less than 1½% of average monthly net assets."

Thus, the shareholders were apprised that even the new expense limitation might be exceeded.

What was this prospective change?

As the proxy statement declared, it ". . . would benefit the Adviser by reducing the *risk* that some or all of the advisory fee would have to be reimbursed to the fund due to an increase in rates or other expenses or *changes in the average account size* of American Investors Fund shareholders. (emphasis added)

Thus, the "risk" and the reasons were disclosed—those very same reasons tabulated on Exhibits 14A (and typewritten on 14B); and discussed by the directors at their second of two meetings at which the change was discussed, which tabulation of number of shareholder accounts and total assets showed the extent to which this Fund had succeeded in meeting the needs of investors of small means.

Nor can plaintiff enhance her case by ignoring stipulated facts. Paragraph 26 of the pre-trial order stipulates the historic record of the Fund as three times as good as the Dow Jones Industrial Index or plus 116.5%, compared with only plus 38.4% on that Index in the same period. Accordingly, the first full sentence on page 10 with reference to "dismal" performance cannot add "materiality" to the routine expenses of postage, printing, and bank charges, and it hardly lies in the mouth of plaintiff who sought to impose an extra $65,000 expense on all shareholders by enjoining the first of the annual meetings. (A-27)

One may question whether "taking a properly realistic view" there would be any "substantial likelihood" that there would have been any "actual significance in the deliberation of the reasonable shareholder" (44 L.W. 4855) or any alteration in the "total mix" — no matter what "avalanche of trivial information" had been expensively printed and mailed to 100,000 shareholders.

Plaintiff's brief does not seek to increase the trial Court's computation of $18,330 damages for calendar year 1973, showing an expense ratio of 1.02% (*including* the advisory fee of 0.57%). Had plaintiff decided not to go along with the vote of the body corporate in the exercise of their franchise, and had exercised instant "appraisal" by redemption—it would not have affected her value per share, since the amount is less than a tenth of a cent per share.

Nor at any time in subsequent calendar year 1974 (the Fund's fiscal year) would her "appraisal" or redemption value have been affected, since it never amounted to as much as one cent per share. (see pp. 13-14, def's. main brief)

The Fund's books have always been kept on a calendar year basis and all of its reportings, federal and state, have been upon such basis, as well as all reports to shareholders. The expense ratio limitation provided in the advisory contract refers to "total charges *per annum* of 1½% of the Corporation's average monthly net assets *for any year*" (emphasis added). Exhibit E shows that in 1974 expenses were $399,683 less than the limitation on the full calendar year basis—the "total charges *per annum*." Since, in any event, shareholders again approved the 1½% limit in 1974, which approval is not under attack in any action, Exhibit E shows that no hypothetical computation could result in exceeding the contract limit. Simply averaging the "per annum" (Exhibit E, p. 3) shows that for the year the expenses were under the limit by $93,815. Treating the 6-month periods separately for computation purposes, and then applying the "per annum" contractual provision shows that for the second half of the "annum", expenses were under the limitation by either $148,035 or $207,621 (the latter figure including extraordinary and non-recurring charges for redemption of small sharehold-

ings estimated to save the Fund shareholders $120,000 to $130,000 every year).

Nevertheless, contrary to the contentions of plaintiff below, and repugnant to the calendar, *annual,* fiscal year of the Fund, the Court below created an eight month/four month split of calendar 1974 for purposes of computations.

Plaintiff has now adopted the Court's hypothetical eight month/four month periods, *but neither the Court below nor plaintiff* has recognized the fact that payments made by the Fund in October 1974 and following had *no impact upon the Fund or any of its shareholders prior to actual payment.*

Payments made in October 1974 (after the second shareholder approval) and following imposed no "bite" or burden prior to actual cash payment. (Nor could any shareholder redeeming prior thereto have suffered injury, since *no possible accrual could have amounted to a penny a share*).

Plaintiff has printed as "Exhibit 2" (pp. 20-25 of her brief) defendant's post trial Exhibit on Damages. The final sentence of ¶13 (page 23) shows that the 1% former limitation was not exceeded by $25,758.80 for that hypothetical 8-month period.

The advisory fee paid in October 1974 of $157,276.87 did not, and could not burden the Fund or its shareholders prior to the date of cash payment. (see ¶15 of such Exhibit) The actual paid and accrued expenses for the first six months of $800,204, plus expenses paid of $43,912.20 in July and August 1974 (total—$844,115.20) are the only items which had any impact on the Fund prior to September 1, 1974 when it is admitted a second shareholder approval had become effective.

Paragraphs 16 and 17 of that Exhibit on Damages (pltf. br., p. 25) summarize and show that there could not—under any theory—be any damage for 1974 or any part thereof.

The Directors Fully Performed Their Fiduciary Duties

Defendants do not "concede" (pltf. br., p. 7) any violation of duty.

Since they "frequently considered rising expenses" (A-49); considered the expense ratio at two separate meetings; sent counsel to California to inquire; and had the full financial statements of the adviser, and pinpointed the problem of expenses, and the reasons therefor in Ex. 14A and 14B, there was no reason to "bury" the directors with any *ad hoc* "avalanche of trivial information."

Their knowledge and performance of duty is sufficiently described in our main brief, pp. 8-12.

CONCLUSION

The decision below is plainly and explicitly wrong and must be reversed on the law, and, further, any damage whatever is precluded.

Respectfully submitted,

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Service of 2 copies of this within
Reply Brief is admitted this
20 day of September 1976

ATTORNEYS FOR Plaintiff and Gov. Appellant

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